



OFFICE OF CHIEF COUNSEL FOR ADVOCACY

U.S. SMALL BUSINESS ADMINISTRATION  
WASHINGTON, D.C. 20416

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Federal Communications Commission  
Office of Secretary

**BY HAND**

Mr. William F. Caton  
Acting Secretary  
Federal Communications Commission  
1919 M Street, Room 222  
Washington, D.C. 20554

Re: In the Matter of Implementation of Cable Act Reform  
Provisions of the Telecommunications Act of 1996,  
CS Docket No. 96-85

Ex Parte Submission

Dear Mr. Caton:

The Office of Advocacy of the U.S. Small Business Administration hereby requests the accompanying ex parte written submission be included in the above-referenced docket. Office transmits herewith the original and four copies.

Thank you in advance for your assistance in this matter. If you have any questions, please contact me at 202/205-6950.

Respectfully submitted,

*David W. Zesiger*  
David W. Zesiger  
Assistant Chief Counsel

Enclosures

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U.S. SMALL BUSINESS ADMINISTRATION  
WASHINGTON, D.C. 20416

OFFICE OF CHIEF COUNSEL FOR ADVOCACY

Before the  
**FEDERAL COMMUNICATIONS COMMISSION**  
Washington, D. C. 20554

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|--------------------------------|---|---------------------|
| In the Matter of               | ) |                     |
|                                | ) |                     |
| Implementation of Cable Act    | ) | CS Docket No. 96-85 |
| Reform Provisions of the       | ) |                     |
| Telecommunications Act of 1996 | ) |                     |

***EX PARTE* SUBMISSION**  
**BY THE OFFICE OF ADVOCACY OF**  
**THE U. S. SMALL BUSINESS ADMINISTRATION**

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November 12, 1996



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## SUMMARY

The Office of Advocacy is making the attached written *ex parte* submission in the Commission's proceeding to implement the Cable Act reform provisions of the Telecommunications Act of 1996 in order to agree with and expand on comments filed earlier in this docket by the SBA Office of Size Standards.

The Office of Advocacy is concerned that the Notice in this proceeding fails to recognize and adequately discuss the impact of some of the changes of the Telecommunications Act of 1996. Specifically, the Notice fails to address the fundamental change in the scope of the Commission's affiliation rules for small cable operators that the 1996 Act appears to have mandated. Section 301(c) of the 1996 Act greatly expanded the scope of the Commission's affiliation rules by referencing all "entities" that may invest in small cable operators. The Commission's existing small system rules restrict as potential affiliates to "cable companies" only. This renders the Notice's extension of rules from the Commission's earlier small system rules inappropriate, particularly insofar as the percentage threshold for affiliation is concerned.

This change makes it all the more important that the Commission adopt the SBA's approach to its affiliation rules, at least for non-MSO investors. This would include recognizing in certain situations the distinction between active and passive investors and between different types of investments. The Commission should also adopt an approach to its percentage threshold for affiliation that more closely tracks the SBA's affiliation rules. This would entail adopting more general principles of affiliation as well as raising the

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***EX PARTE* SUBMISSION  
BY THE OFFICE OF ADVOCACY OF  
THE U. S. SMALL BUSINESS ADMINISTRATION**

The Office of Advocacy of the United States Small Business Administration makes the following *ex parte* submission in the above-captioned proceeding. The Office of Advocacy was established by Congress in 1976 to serve as a voice for small business within the federal government. Its statutory duties include serving as a focal point for concerns regarding the federal government's policies as they affect small business, representing the views of small business before other federal agencies, developing proposals

for changes in federal agencies' policies and communicating these proposals to the agencies. 15 U.S.C. 634c(1)-(4).

These *ex parte* comments expand upon the comments previously filed in this docket by the Office of Size Standards of the Small Business Administration and further elaborate on the suggestions made therein.<sup>1</sup> In its comments, the Office of Size Standards made two recommendations regarding the Commission's proposed affiliation rules for small businesses which will be addressed at greater length herein: (1) that the Commission should further elaborate its affiliation rules for small cable operators, and (2) that the Commission should model its affiliation rules for small cable operators on the SBA's affiliation rules.<sup>2</sup>

## **I. The Office of Size Standards Recommendations**

The comments filed by the Office of Size Standards asserted the fundamental need for the Commission to elaborate further on its proposed affiliation rule for small cable operators. The Notice failed to do more than

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<sup>1</sup> Comments of the Assistant Administrator for Size Standards of the U.S. Small Business Administration ("Office of Size Standards Comments").

and investors.<sup>3</sup> The Office of Size Standards stated specifically: “It may be advisable for the Commission to expand upon its definition of affiliates as it has done in other Commission’s regulations...”<sup>4</sup> The Office of Advocacy agrees with this recommendation and will develop additional reasons for this below. The Office of Advocacy believes that without such further elaboration, the Commission may inadvertently exclude many small cable operators from the administrative and regulatory relief it intended for such operators.

The Office of Size Standards also recommended that the Commission look to the definition of affiliation as set forth in the SBA’s rules to determine “the types of relationships that give rise to affiliation.”<sup>5</sup> The Office of Advocacy agrees with the Office of Size Standards’ recommendation and will explore herein several aspects of the SBA’s affiliation rules which could assist the Commission in determining such questions for small cable operators.

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<sup>3</sup> In the Matter of Implementation of Cable Act Reform Provisions of the Telecommunications Act of 1996, *Order and Notice of Proposed Rulemaking*, CS Docket No. 96-85 (released April 9, 1996) at ¶¶ 26, 82-3 (“Notice”).

<sup>4</sup> Office of Size Standards Comments at 3.



## **II. The 1996 Act Fundamentally Changed the Scope of the Commission's Affiliation Rules.**

Section 301(c) of the Telecommunications Act of 1996 ("the 1996 Act") significantly deregulated rates and administrative burdens for small cable operators.<sup>6</sup> At the same time, Section 301(c) expanded the scope of this deregulation by significantly raising the threshold of what is considered a "small cable operator". The 1996 Act defines a small cable operator as one that serves "fewer than 1 percent of all subscribers in the United States and is not affiliated with any entity or entities whose gross annual revenues in the aggregate exceed \$250,000,000."<sup>7</sup> By using the very broad term "entity or entities", however, Section 301(c) expanded the types of relationships covered by the term "affiliate" well beyond the Commission's previous practices.

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<sup>5</sup> *Id.* The SBA's affiliation rules are located at 13 C.F.R. § 121.103. A copy of these are attached as Appendix A.

<sup>6</sup> The Telecommunications Act of 1996, Pub. L. No. 104-104, 100 Stat. 56 (1996) ("1996 Act").

<sup>7</sup> 1996 Act, § 301(c).

Prior to the 1996 Act, the Commission had established a narrow scope for its affiliation rule for small systems chiefly by limiting the types of affiliations the rule covered to those between small cable operators and other, larger cable companies.<sup>8</sup> The Commission's regulations state, "[a] small system will be considered affiliated with a cable company if the company holds a 20 percent or greater equity interest in the system...."<sup>9</sup> The Commission did not take into account ownership relations with other entities. The purpose of this narrow scope was to exclude from treatment as a small cable operator" only those smaller operators which, because of their connection with larger operators, would have access to greater resources and expertise and would be more able to cope with the burden of the Commission's rules. The Commission stated: "Where a larger company is so affiliated with the small system, we believe the system will have access to the resources it needs to grow as well as larger systems, and hence should not be in need of the relief we will accord to small systems that have no such access."<sup>10</sup> The small system affiliation threshold also insured that larger

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<sup>8</sup> *Sixth Report and Order and Eleventh Order on Reconsideration* in MM Docket Nos. 92-266, & 93-215, FCC 95-196, 10 FCC Rcd 7393 (1995) ("Small System Order") at ¶ 36, footnote 88.

<sup>9</sup> 47 C.F.R. § 76.934(a) (emphasis supplied).

<sup>10</sup> Small System Order at fn. 88.

operators would not benefit inappropriately from the Commission's small system rules.

The 1996 Act changed the nature and impact of the Commission's small system affiliation rules. Its use of the terms "entity or entities" went well beyond the Commission's exclusive focus on affiliations between cable operators. The Act mandates affiliation rules which cover a wide array of relationships, including those between institutional investors and cable operators – relationships that have traditionally not been subject to scrutiny under the Commission's affiliation rule for small systems. Furthermore, the underlying rationale for the Commission's original affiliation rule no longer provides an adequate basis for the rule. Most institutional investors who invest in small cable operators do not have the "resources" larger cable operators have to offer smaller affiliates: operating expertise, supplier relationships, experienced regulatory staff, etc. Such operators will still generally be in need of the kind of relief the Commission's small system rules offer.

The legislative history does nothing to clarify Congress' intent in making this change in the scope of the Commission's affiliation rules.<sup>11</sup> Moreover, the Notice neither discusses this fundamental shift in policy nor requests any comment on it. In fact, it appears to assume the opposite – that the 1996 Act made no changes significant enough to warrant reexamination of its existing rules.<sup>12</sup> Yet it is clear from comments filed in this docket that this shift will profoundly affect smaller cable operators' ability to qualify for the administrative and rate relief Congress and the Commission have provided for smaller systems as well as diminish their ability to attract capital.<sup>13</sup>

The practical effect of the 1996 Act's shift in language could well be to discourage investment in small cable operators. A common pattern of financing for small cable operators involves a much larger institutional investor investing a disproportionate share of capital in the operator. In

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<sup>11</sup> The legislative history does no more than restate the language of Section 301(c). *See*, Joint Explanatory Statement of the Committee of Conference. S. Conf. Rep. No. 104-230, 104<sup>th</sup> Cong., 2d Sess. at 167-170 (1996).

<sup>12</sup> The Notice states: "In the present context, we believe it is reasonable to apply our definition of affiliation as it exists under our small system rules, given that those rules and the small cable operator provisions of the 1996 Act all have the same intent of minimizing regulation and ensuring access to needed capital for smaller cable entities." Notice at ¶ 26.

<sup>13</sup> *See, e. g.*, SCBA Comments, G.E. Capital Corporation Comments, and J.P. Morgan, et. al. Comments.

return, such investors typically receive a significant equity stake in the operator. Yet, few if any of these investors actually exercise control over the operator apart from rare situations that threaten the viability of the operator. If the Commission applies its proposed single standard without further elaboration of its affiliation rule, it is likely to bring many such inherently passive investment relationships under its rule. It is also likely to set an inappropriate percentage threshold for what it considers to constitute affiliation with a small cable operator.

Given the 1996 Act's fundamental shift in scope, the Office of Advocacy urges the Commission to reassess its proposed affiliation rules. If the Commission simply applies rules developed in previous proceedings without addressing the different impact those rules would have herein, it is almost certain not to achieve its stated policy goals and is likely to disadvantage a significant numbers of small cable operators.

### **III. The SBA's Affiliation Rules Should Serve as a Model for the Commission's Affiliation's Rules.**

The SBA's affiliation rules have been developed over time and reflect the accumulated experience of the agency on this subject. The rules generally help determine which businesses qualify for the SBA's programs or qualify to benefit from its rules. They serve virtually the identical function for SBA programs as the proposed affiliation rules will for the Commission's small system programs.

#### **A. The SBA Establishes General Principles of Affiliation.**

The SBA rules begin by stating general principles of affiliation that guide the application of its rules. The primary and overriding principle is that "[c]oncerns are affiliates of each other when one concern controls or has the power to control the other...."<sup>14</sup> This is a purposefully broad standard which informs and undergirds the remainder of the rules. It asserts the fundamental policy concern at stake: when one firm controls another, that other firm cannot in reality be said to be an independent entity and should be analyzed in

conjunction with the first firm. These broad principles of affiliation effectively preserve the SBA's power to intervene in situations its rules might otherwise not address.<sup>15</sup> The Office of Advocacy recommends that the Commission establish the same central tenet as the organizing principle for the affiliation rules it promulgates.<sup>16</sup>

The instant Notice takes a very different approach to the affiliation rule it proposes. Instead of elaborating general principles of affiliation, it simply proposes a 20 percent ownership threshold at which it will find affiliation in virtually all cases. While such a simple numerical standard functioned adequately under the Commission's previous rules, the changes made by the 1996 Act require greater elaboration if the rule is not to disadvantage numerous small operators unfairly. The Office of Advocacy recommends that the Commission adopt broader principles of affiliation that will guide the rule's implementation in the wide variety of cases it will confront in the future.

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<sup>14</sup> 13 C.F.R. § 121.103(a)(1).

<sup>15</sup> The Notice references a similar reservation of power based on a similar principle but does so only in passing and almost as an afterthought. The Notice states: "*De facto* control also would constitute affiliation." Notice at ¶ 83.

**B. The SBA Excludes Certain Types of Investments and Investors From its Affiliation Rules.**

The SBA's rules take into account a variety of types of investors and investments that do not trigger a finding of affiliation. These distinctions and exclusions are carefully tailored and serve to keep the SBA's affiliation rules from inappropriately excluding significant numbers of small businesses from the benefits of SBA programs. The Office of Advocacy recommends that the Commission incorporate such distinctions in its final affiliation rule for small cable operators.

Investors. The SBA's affiliation rules distinguish between different types of investors. Section 103(b) excludes a variety of investors from the scope of the SBA's affiliation rules, including investments by Small Business Investment Companies, mutual funds, pension funds and a variety of other types of investing entities. These are typically the types of investing relationships where investors do not exercise control over the small entity and

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<sup>16</sup> The Commission takes just such an approach in its attribution rules. *See*, 47 C.F.R. § 73.3555, Note 1, and 47 C.F.R. § 76.501, Note 1.



where investment is motivated by a desire to earn a return and not to control the management and operations of a small entity.<sup>17</sup> The SBA rules exclude such investments so as not to discourage such investment in small businesses. The Office of Advocacy recommends the Commission determine which such sources of investment are made for similar motivations in the cable industry and exclude them from the scope of its affiliation rules.

Investments. The SBA's affiliation rules also distinguish between different types of investment. For example, the SBA's affiliation rules use equity ownership as one measure of potential affiliation, but focus only on ownership of voting stock. Section 103(c)(1) states:

A person is an affiliate of a concern if the person owns or controls, or has the power to control 50 percent or more of its voting stock, or a block of stock which affords control because it is large compared to other outstanding blocks of stock.<sup>18</sup>

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<sup>17</sup> 13 C.F.R. § 121.103(b).

<sup>18</sup> 13 C.F.R. § 121.103(c)(1) (emphasis supplied).

This provision has been consistently interpreted by the SBA to encompass voting stock and to exclude non-voting stock. While the SBA's rules do not set a clear threshold percentage at which non-voting stock is deemed to be a controlling interest, the SBA retains its general authority to find *de facto* control in any situation.

There are situations, however, where even passive investors like these are in a position to control the business in which they invest. The SBA deems such investors to be affiliated if they are in control or in a position to control the small business. The Commission should also include rules defining when such passive investors actually exercise control to preclude abuses of this exception. The Commission should also retain its general authority to find *de facto* control in spite of the form of investment.

In contrast, the SBA's affiliation rules give present effect to other types of investment such as stock options and convertible debentures when determining affiliation.<sup>19</sup> The guiding principle is whether such financial instruments give their owners control or the power to control the small business in question. Since such instruments will give their owners a voting

stock interest at a future date, they should generally trigger affiliation treatment.

Finally, the Commission should expressly incorporate into its affiliation rule a waiver provision allowing any entity to apply for a waiver on a case-by-case basis. The Commission's attribution rules provide for such a waiver process but restrict its use to certain narrow situations.<sup>20</sup> This is appropriate in the context of multiple ownership and cross-ownership rules where media concentration is at issue. Waivers to qualify for small system status should be more generally available unless larger multiple system operators (which trigger the same concerns over media concentration) are involved.

**C. The Commission Should Adopt the SBA's Approach to Setting Percentage Thresholds for its Affiliation Rules.**

The Office Of Size Standards' comments addressed the Commission's proposed percentage threshold for affiliation. That office restated the Commission's proposal without providing specific commentary on the

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<sup>19</sup> 13 C.F.R. § 121.103(d).

<sup>20</sup> See 47 C.F.R. § 73.3555, Note 7, and 47 C.F.R. § 76.501, Note 7.

proposal itself.<sup>21</sup> In light of the foregoing comments, the Office of Advocacy believes it is necessary to further elaborate the Office of Size Standards' comment with a more detailed discussion at this time.

The Notice proposed to adopt a 20 percent threshold for the Commission's affiliation rule for small cable operators.<sup>22</sup> The Notice made it clear that the 20 percent threshold was taken directly from the Commission's small system rules. As noted above, however, the 1996 Act radically changed the scope of the Commission's affiliation rules, a fact not taken into account by the Notice. The Act mandates affiliation rules that encompass **all** ownership relations and not simply ownership relations between cable operators. The 20 percent threshold therefore would have a completely different effect in the context of this newly expanded affiliation rule than in the preexisting small system rules. The Office of Advocacy believes that this change makes the application of the 20 percent threshold inappropriate and mandates a different approach to setting the percentage threshold for affiliation.

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<sup>21</sup> Office of Size Standards Comments at 3.

<sup>22</sup> Notice at ¶ 83.

The Office of Advocacy recommends the Commission adopt the approach taken by the SBA's affiliation rules when setting its percentage threshold for affiliation. The SBA's threshold has functioned well over the years in determining which small businesses are independently owned and operated and which are not. The SBA finds a person to be an affiliate when that person "owns or controls, or has the power to control 50 percent or more of its voting stock...."<sup>23</sup> The SBA's affiliation rules set out exceptions to this rule which cover ownership situations of less than 50 percent. For example, the SBA treats as affiliates persons that own minority holdings that, when aggregated, are large as compared with any other stock holdings in the company.<sup>24</sup>

The SBA affiliation rules also define affiliation in many ways that do not use percentage thresholds. The SBA finds entities to be affiliated when one firm controls or has the power to control another.<sup>25</sup> This includes cases of *de facto* control which the Notice expressly proposed to cover. The SBA employs a broad range of factors that generally indicate control or the power to control, including: previous relationships with or ties to another concern,

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<sup>23</sup> 47 C.F.R. § 121.103(c)(1).

<sup>24</sup> 47 C.F.R. § 121.103(c)(2).

contractual relationships, substantially identical business interests, economic dependence through contractual or other relationships, etc.<sup>26</sup>

The SBA's approach to determining whether affiliation exists is closely related to that which was mandated by the 6<sup>th</sup> Circuit in *Cincinnati Bell v. FCC*, where the court reviewed the Commission's cellular attribution standard for its cellular/PCS crossownership rule.<sup>27</sup> The court stated that such an attribution standard "must bear some reasonable relationship to [an] entity's ability to control the Cellular licensee."<sup>28</sup> While the Commission took a different approach to the issue of control generally in its rulemaking on remand, it singled out small businesses and rural telephone companies for treatment closely resembling the court's and the SBA's approach. The Commission reasoned that "relaxed attribution rules [for small businesses] present a situation entirely different from the 20 percent attribution rule."<sup>29</sup> The predominant policy concern for small businesses in this rulemaking (as

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<sup>25</sup> 47 C.F.R. 121.103(a)(1).

<sup>26</sup> 47 C.F.R. § 121.103(a)(2)-(3).

<sup>27</sup> *Cincinnati Bell v. FCC*, 69 F.3d 752 (4<sup>th</sup> Cir. 1995).

<sup>28</sup> *Id.* at 759 (emphasis supplied).

<sup>29</sup> In the Matter of Amendment of Parts 20 and 24 of the Commission's Rules – Broadband PCS Competitive Bidding and the Commercial Mobile Radio Service Spectrum Cap, *Report and Order*, 11 FCC Rcd. 7824 at ¶ 124 (1996).

well as in the instant proceeding) was access to capital.<sup>30</sup> The Commission stated: “One of the most formidable barriers to ... participation [in the provision of wireless services] is the difficulty such businesses face in raising sufficient capital to compete....”<sup>31</sup> In response, the Commission maintained a significantly higher percentage attribution threshold for small businesses, stating: “By increasing the attribution threshold for such designated entities and their investors, our goal was to make capital more readily available.”<sup>32</sup>

The Office of Advocacy believes this reasoning applies with equal, if not greater force for small cable operators. Small cable operators typically have even greater difficulty attracting capital than high-profile PCS bidders. Moreover, cable television, a relatively mature industry, is generally seen to be less attractive to investors than a new industry such as PCS. The Commission should take all the steps reasonably within its power – including

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<sup>30</sup> The Office of Advocacy would readily concede that the policy consideration behind the remainder of the Commission’s cellular/PCS crossownership ban – avoiding concentration and increasing competition in the CMRS market – justifies a more stringent attribution standard. In this and other crossownership or multiple ownership rules, even a minority ownership stake could give the outside company inappropriate influence over another company. These same policy concerns also underlie, *e.g.*, the Notice’s more rigorous affiliation standards for LEC affiliation under the proposed effective competition test. See Notice at ¶¶ 15-16.

<sup>31</sup> *Id.*

adopting the SBA's approach to percentage thresholds – to help small cable operators attract the necessary capital to run their businesses.

#### **IV. Conclusion**

Ultimately, without further elaboration of the Notice's proposed affiliation rules along the lines of the SBA's example, those rules will almost certainly have the effect of discouraging investment in small cable operators and seriously complicating their efforts to raise the capital necessary to run their businesses. This outcome would be contrary to the intent of Congress in enacting deregulation for small cable operators and contrary to the Commission's intent in promulgating its small system rules. Adopting the SBA's approach to affiliation rules would do much to alleviate these potential problems.

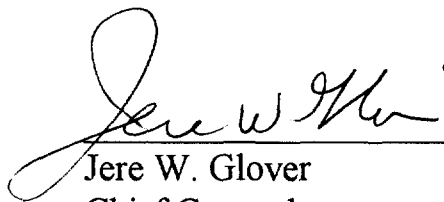
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<sup>32</sup> *Id.*



For the foregoing reasons, the Commission should adopt rules consistent with these additional suggestions offered in this *ex parte* submission.

Respectfully submitted:

  
\_\_\_\_\_  
Jere W. Glover  
Chief Counsel  
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David W. Zesiger  
Assistant Chief Counsel  
for Telecommunications

November 12, 1996